UNITED STATES OF AMERICA
BEFORE THE
SURFACE TRANSPORTATION BOARD

CF INDUSTRIES, INC.,	)	
Complainant,	)	
	)	
v.	)	
	)	
KANEB PIPE LINE PARTNERS, L.P.,	)	**Docket No. 42084**
	)	
and	)	
	)	
KANEB PIPE LINE OPERATING PARTNERSHIP, L.P.,	)	
Defendants.	)	

REBUTTAL OF KANEB PIPE LINE PARTNERS, L.P. AND KANEB PIPE LINE OPERATING PARTNERSHIP, L.P. TO DYNO NOBEL, INC.'S OPPOSITION TO DEFENDANTS' REQUEST FOR VACATION OF MAY 9, 2000 RATE PRESCRIPTION ORDER

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REBUTTAL OF KANEB PIPE LINE PARTNERS, L.P. AND KANEB PIPE LINE OPERATING PARTNERSHIP, L.P. TO DYNO NOBEL, INC.'S OPPOSITION TO DEFENDANTS' REQUEST FOR VACATION OF MAY 9, 2000 RATE PRESCRIPTION

Pursuant to the Board's October 13, 2004 Decision[1] granting the petition of Dyno Nobel, Inc. ("DNI") to intervene in this proceeding, Kaneb Pipe Line Partners, L.P. and Kaneb Pipe Line Operating Partnership, L.P. (collectively, "Kaneb") hereby submit their Rebuttal to the Opposition of DNI to Kaneb's Request for Vacation of the May 9, 2000 Rate Prescription Order. As discussed in more detail below, because DNI does not dispute Kaneb's evidence, which demonstrates that circumstances on the anhydrous ammonia ("AA") pipeline at issue have changed materially since the Board imposed the

[1] CF Industries, Inc. v. Kaneb Pipe Line Partners, L.P. and Kaneb Pipe Line Operating Partnership, L.P., STB Docket No. 42084 (STB served October 13, 2004) ("October 13 Decision").

rate prescription in CF Industries, Inc. v. Koch Pipeline Company, L.P.,[2] the Board should lift the rate prescription and restore ratemaking initiative to Kaneb.

I. INTRODUCTION

On September 13, 2004, in accordance with the Board's August 11 Decision in this proceeding,[3] Kaneb submitted evidence of materially changed circumstances on its AA pipeline, demonstrating that the factual underpinnings of the Koch decision no longer have validity, and arguing that the Board should lift the rate prescription, based on the materially changed circumstances. CF Industries, Inc. ("CFI"), the complainant in this case, replied to Kaneb's Opening Evidence and Argument on October 7. Kaneb submitted its Rebuttal to CFI's Response to Kaneb's Opening Evidence and Argument ("Rebuttal to CFI") on October 14. On October 13, the Board granted DNI's untimely September 17, 2004 Petition to Intervene on the basis that doing so would not unduly disrupt the proceeding.[4]

In its Opposition, DNI ignores the Board's requirement that its submission "be limited to addressing the issue of whether the factual and legal underpinnings of the Koch

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[2] CF Industries, Inc. v. Koch Pipeline Company, L.P., 4 S.T.B. 637 (2000) ("Koch"), aff'd sub nom. CF Industries, Inc. v. STB, 255 F.3d 816 (D.C. Cir. 2001).

[3] CF Industries, Inc. v. Kaneb Pipe Line Partners, L.P. and Kaneb Pipe Line Operating Partnership, L.P., STB Docket No. 42084 (STB served August 12, 2004) ("August 11 Decision").

[4] Kaneb opposed DNI's Petition to Intervene, because in addition to its untimeliness, (1) DNI's rates are not subject to the Koch prescription; (2) DNI's interests are protected in its own case; and (3) DNI's involvement unnecessarily complicates and delays this proceeding. DNI has not only replied to Kaneb's Opening Evidence and Argument, but has also piggybacked off CFI's Response, and responded to Kaneb's Rebuttal to CFI, thereby in reality filing the equivalent of a sur-rebuttal to Kaneb's Rebuttal to CFI—an opportunity that even the complainant in this case did not enjoy. In addition, DNI has impermissibly discussed and mischaracterized certain evidence and data responses in its own case which are irrelevant to the issue in this proceeding.

prescription remain valid."[5] DNI, like CFI, does not submit any evidence disputing Kaneb's evidence of materially changed circumstances, or whether the factual and legal underpinnings of the Koch prescription remain valid. Instead, DNI mischaracterizes the issue that is before the Board, raises arguments wholly irrelevant to the narrow issue before the Board, and makes sweeping, unsubstantiated statements about pipelines subject to the Board's jurisdiction in general and Kaneb in particular. DNI effectively requests that the Board disregard its decision in Koch and depart from its policy of utilizing acquisition cost valuation to determine the value of a pipeline's investment base. As discussed in more detail below, granting DNI's request in this proceeding would be both contrary to the Board's precedent and arbitrary and capricious.

As Kaneb noted in its Rebuttal to CFI, in the Koch decision, the Board stated that it stood "ready to promptly lift the rollback and prescription if and when such action should be shown to be necessary."[6] Kaneb has demonstrated that it is now necessary for the Board to lift the prescription, and its evidence of materially changed circumstances is undisputed by CFI and DNI. Therefore, rather than continue indefinitely the 16-year freeze on rates that both CFI and DNI advocate, the Board should lift the prescription to allow Kaneb to earn a reasonable return on its investment, consistent with the Board's ratemaking principles.

II. DNI HAS NOT DISPUTED ANY EVIDENCE SUBMITTED IN SUPPORT OF KANEB'S CLAIM OF MATERIALLY CHANGED CIRCUMSTANCES.

In its August 11 Decision, the Board directed Kaneb to submit further information

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5 October 13 Decision at 2.

6 Koch, 4 S.T.B. at 662.

regarding materially changed circumstances in order to determine whether to vacate the existing rate prescription the Board imposed in Koch. Specifically, the Board noted that Kaneb had not indicated "what assets were encompassed in [the] purchase price and how much of the purchase price is attributable to the pipeline itself."[7] Therefore, the Board requested that Kaneb submit:

> [A] list of the assets Kaneb purchased from Koch and an itemized valuation of those assets; a comparison to the assets that the Board examined in Koch; the complete Koch/Kaneb asset purchase and sale agreement; a statement setting forth facts sufficient to establish whether or not the purchase was an arm's length transaction; and any other information relevant to [Kaneb's] claim of materially changed circumstances.[8]

In compliance with the Board's order, Kaneb submitted a copy of the Koch/Kaneb Asset Purchase and Sale Agreement ("Purchase Agreement"); a verified statement regarding the arm's length nature of the Purchase Agreement transaction with Koch; and a comparison of the pipeline assets to demonstrate that the assets Kaneb purchased from Koch were substantially the same assets examined by the Board in Koch. Kaneb also submitted verified statements further demonstrating its claim of materially changed circumstances, including: (1) Kaneb's acquisition costs in an arm's length transaction for the pipeline assets, which substantially exceed the pipeline valuation underlying the Koch prescription; (2) Kaneb's average operating costs and capital expenditures, which exceed the average operating costs and capital expenditures the Board examined in Koch; (3) volumes on the pipeline, which have decreased since the Board examined them in Koch; and (4) revenues generated from the pipeline, which have decreased since the Board imposed the Koch rate prescription. In addition, Kaneb

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7 August 11 Decision at 4.

8 Id.

submitted an analysis for illustrative purposes demonstrating that, based on the material change in circumstances, Kaneb's return on investment, when compared to a conservative cost of capital benchmark, would have substantially different results from the similar comparison which underlies the Board's determination in Koch.

DNI's Opposition fails to dispute any of the evidence Kaneb submitted regarding materially changed circumstances on the pipeline. First, DNI does not dispute that the assets Kaneb purchased from Koch are substantially the same assets that the Board examined in the Koch case. Second, DNI does not dispute that Kaneb paid $140 million for those assets, nor that the Purchase Agreement was negotiated at arm's length. Third, DNI does not dispute that Kaneb's average operating costs and capital expenditures exceed the average operating costs and capital expenditures the Board examined in Koch. Fourth, DNI does not dispute that volumes of AA shipped on the pipeline have decreased since the Board examined them in Koch. Finally, DNI does not dispute that revenues generated from the pipeline have decreased since the Board imposed the Koch rate prescription.

Instead of disputing Kaneb's evidence of materially changed circumstances, DNI simply asserts, without citation to any legal authority, that Kaneb has failed to demonstrate that any of the changes, singly or in combination, are material changes.[9] DNI further asserts that Kaneb has not shown any of the changes to be material because

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[9] DNI Opposition at 2. DNI creates an irrelevant, inexplicable hypothetical involving a 40% decrease in pipeline volumes originating in Louisiana and a "comparable" increase in imported volumes, which it states would (naturally) have a de minimis net effect on revenues and profits. DNI Opposition at 3 n.5. Kaneb's evidence reflects a decrease in all volumes shipped on the pipeline, regardless of origin. Thus, DNI's "hypothetical" bears no relation to the undisputed facts in this case and should be disregarded.

Kaneb has not proven that "had such changed circumstances been present or known in 2000 they would have dictated a different outcome in Koch."[10] DNI misconstrues the Board's precedent regarding materially changed circumstances entirely.

In determining whether to vacate a rate prescription and restore ratemaking initiative to the carrier, the Board must assess whether the factual and legal bases of the prescription remain valid,[11] not, as DNI suggests, whether circumstances today, if they were known when the rate prescription was imposed, would have dictated a different outcome at the time the prescription was imposed. Nor is vacation of a rate prescription appropriate, as DNI mistakenly contends, "only when the carrier demonstrates that circumstances have changed so drastically that there is no longer any basis for maintaining any prescriptive control whatsoever over the carrier's rates."[12] DNI's citation to Trainload Rates on Radioactive Materials, for that proposition is misplaced. In that decision, the ICC merely stated that reopening (or vacation) of a rate prescription is appropriate "upon a finding of material error, new evidence, or changed circumstances."[13]

Contrary to DNI's assertions, Kaneb has not suggested that the Board consider any of its evidence of materially changed circumstances in a vacuum, or "in the abstract."[14] Instead, Kaneb has given the Board the complete picture of the changes on

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10 DNI Opposition at 2.

11 San Antonio, Texas v. Burlington Northern, Inc., 364 I.C.C. 887 (1981), 1981 ICC LEXIS 78, at *21; Arizona Public Service Co. v. The Burlington Northern & Santa Fe Ry. Co., STB Docket No. 41185, slip op. at 6 (STB served May 12, 2003).

12 DNI Opposition at 3 n.4.

13 Trainload Rates on Radioactive Materials, Eastern Railroads, 1991 ICC LEXIS 7, at *10 (Jan. 9, 1991).

14 DNI Opposition at 3.

the pipeline since the Board imposed the Koch rate prescription, and taken together—or even alone—the changes demonstrate that the factual and legal bases of the prescription are no longer valid. In fact, although Kaneb submitted evidence of all of the changes individually, it also submitted evidence showing the net effect of the changes taken together: that Kaneb's return on investment, when compared to a conservative cost of capital benchmark, would have substantially different results from the similar comparison which underlies the Board's determination in Koch.[15]

Because DNI has failed to dispute any of the evidence Kaneb submitted to demonstrate material changed circumstances, the Board should lift the rate prescription it imposed in Koch and return ratemaking initiative to Kaneb.[16]

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[15] Contrary to DNI's assertions, the changes are indeed sufficient to lift the prescription, because the factual and legal underpinnings of the Koch decision are no longer valid. See San Antonio, TX, 1981 ICC LEXIS 78, at *14-15 (lifting a 5-year old rate prescription because it was no longer supported by current cost data or current legal standards); see also Koch, 4 S.T.B. at 662-63 n.70 (describing Koch's change in volume, an increase from 1.1 million tons to 1.8 million tons as "substantial"). Kaneb's evidence regarding the decrease in volumes of AA shipped on the pipeline demonstrates that volumes for 2004 are projected to be nearly as low as the lowest year for which the Board examined volumes in Koch, and the year for which the Board found Koch to be revenue inadequate. Koch, 4 S.T.B. at 682, App. 11, table 5. DNI submitted no evidence contesting this substantial change in circumstance.

[16] DNI, like CFI, appears to believe that the return of ratemaking initiative to Kaneb will result in higher rates, followed by "another protracted maximum rate case simply to relitigate the issues addressed and resolved in Koch." DNI Opposition at 10. Both DNI and CFI appear to have already made up their minds to challenge any rate increase by Kaneb. In contrast to the history of the AA pipeline at issue in this case, the majority of pipelines subject to the Board's jurisdiction have entered into multiyear contracts with shippers to provide guaranteed rates in return for minimum shipment volumes. See Government Accountability Office [formerly the General Accounting Office], Issues Associated with Pipeline Regulation by the Surface Transportation Board, GAO/RCED-98-99 at 8 (April 1998) ("GAO Report"). Therefore, if the Board lifts the prescription, it will not be "forcing" the parties to challenge any future rates. Such action is solely within the discretion of CFI and DNI. Moreover, if Kaneb issued new rates following the lifting of the prescription and any party chose to file a complaint, the facts and the issues would be entirely different from those in Koch.

III. DNI'S ARGUMENTS ARE INAPPOSITE TO THE ISSUE OF WHETHER THE RATE PRESCRIPTION SHOULD BE LIFTED.

Rather than offer evidence disputing Kaneb's evidence of materially changed circumstances, DNI raises arguments to distract the Board from the issue in this proceeding: whether the Board should alter or lift the rate prescription it imposed in Koch based on a material change in circumstances. Although DNI first mistakenly framed the issue before the Board as "what magnitude of increase is justified by Kaneb's evidentiary showing,"[17] in a change of position, DNI now contends that the issue before the Board is "whether to allow otherwise-unreasonable rate increases, based solely on a large acquisition premium paid by a pipeline's purchaser."[18] DNI's most recent characterization of the issue is no more accurate than its first, and it raises no arguments not already raised by CFI.

Despite DNI's attempt to reword CFI's argument in terms of "write-up" and "acquisition premium,"[19] DNI is simply, like CFI, attempting to rewrite the Koch decision by suggesting that the Board did not address acquisition cost valuation in Koch, and to rewrite regulatory history by advocating that the Board break from its well-established precedent regarding acquisition cost valuation to treat Kaneb's pipeline—and

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17 DNI Petition to Intervene at 4. As Kaneb notes here, and in its Rebuttal to CFI, Kaneb is not seeking to raise its rates in this proceeding, nor has Kaneb requested that the Board conduct a revenue adequacy review to determine the "magnitude of a rate increase that may be justified." None of the parties have submitted evidence to support modification of the Koch prescription. Both CFI and DNI have requested that the Board keep the existing prescription in effect. Kaneb has advocated lifting the prescription.

18 DNI Opposition at 10.

19 DNI does not explain what it means by "acquisition premium." Kaneb assumes that it has in mind the same definition that the Board uses, i.e., "the excess of the price paid to acquire [assets] over the pre-acquisition book value of the [assets]." Union Pacific Corporation, et al., STB Finance Docket No. 32760, slip op. at 2 (STB served Oct. 22, 2002).

Board-regulated pipelines in general—more like Federal Energy Regulatory Commission ("FERC")-regulated natural gas pipelines and electric utilities. DNI, like CFI, appears to be asking the Board to determine that any rate increase is unreasonable in advance of the issuance of new rates. Although DNI requests that the prescription remain in effect "until such time as Kaneb can make a sufficient showing of materially changed circumstances to justify alteration or revocation of that prescription,"[20] it is difficult to imagine that any showing would be "sufficient" in DNI's view. None of DNI's arguments are remotely relevant in the context of this proceeding to lift the rate prescription. However, the arguments warrant response to the extent that they misconstrue the Board's precedent and its applicability to Kaneb's AA pipeline.

A. The Board Squarely Addressed the Issue of Acquisition Cost in Koch.

Although DNI concedes that the Board uses acquisition cost valuation in revenue adequacy determinations and accepts investment bases that have been written-up based on "acquisition premiums" in the rail context, it incorrectly argues that the Board's use of acquisition cost with respect to Board-regulated pipelines is "an issue of first impression."[21] DNI acknowledges that the Board in Koch accepted and applied acquisition cost pricing for rate base purposes,[22] yet it erroneously claims that the Board looked only at acquisition cost v. replacement cost and that "the write-up issue remains

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20 DNI Opposition at 10.

21 Id. at 5.

22 Id. at 9. Ironically, DNI credits CFI for pointing out the Board's use of acquisition cost in Koch, yet in its Response, CFI erroneously suggests that the Board used predecessor cost, not acquisition cost, in Koch.

undecided."[23] DNI's suggestions to the contrary, the issue of acquisition cost v. predecessor cost was squarely addressed in the Koch decision, and there is no reason that the Board should depart from its precedent here.

In applying its acquisition cost valuation policy in the Koch case, the Board stated that:

> Koch cannot rely on the costs incurred by the pipeline's previous owners, but only on those that it has incurred itself. Thus, Koch's 1988 acquisition provided a new investment base. This approach is fully consistent with [G]enerally [A]ccepted [A]ccounting [P]rinciples (GAAP) for reporting asset values and related expenses. Under GAAP, purchasers may, upon acquisition, write up or write down assets, as appropriate, to more accurately reflect their value. . . Acquisition cost valuation – the amount paid in an arm's-length transaction – is consistent with 'what other business enterprises use for measuring their investments.'[24]

The D.C. Circuit approved the Board's use of acquisition cost in Koch as the investment base upon which to determine revenue adequacy.[25]

Contrary to DNI's assertion, Koch did not pay "book value or predecessor cost" for the pipeline assets.[26] In Koch, the Board indicated that it was compelled to use Koch's valuation of the pipeline assets on the company's 1988 FERC Form 6 as a "reliable estimate" of its acquisition cost, because Koch did not "write up the AA pipeline assets or provide any other evidence showing a valuation different from [the amount] it allocated to those assets in its 1988 regulatory filings."[27] Although Koch itself

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23 Id.

24 Koch, 4 S.T.B. at 658-59.

25 CF Industries, Inc., 255 F.3d at 830.

26 DNI Opposition at 9.

27 Koch, 4 S.T.B. at 659.

argued that the $77.2 million was not Koch's "true" acquisition cost,[28] in affirming the Board's use of Koch's FERC Form 6 valuation as the value of its "cost of acquiring – and the value of its initial investment in – the pipeline," the D.C. Circuit stated that "Koch submitted no other figure for its investment base to the STB, notwithstanding the Board's direction in its initial order that the parties' evidence 'should include . . . pipeline investment.' Nor has Koch suggested an alternative figure on this appeal."[29] Therefore, the court indicated that Koch had the opportunity, even as late as the appeal, to write-up its investment to reflect its true acquisition cost.

Clearly, contrary to DNI's assertion in this proceeding, the Board has indeed addressed the issue of whether the write-up (or write-down) included in an acquisition cost results in an appropriate investment base in a pipeline proceeding, and the Board has strongly indicated that it allows the write-up in acquisition cost in pipeline cases, and would have allowed it in Koch, if Koch had provided such evidence, just as it does in its railroad proceedings. Kaneb, as the new owner of the pipeline, should not be penalized for Koch's refusal to submit evidence of its true acquisition cost. Kaneb submitted the evidence required by the Board's August 11 Decision relating to Kaneb's investment in and purchase of the pipeline, and DNI has not disputed that evidence.[30]

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28 CF Industries, Inc., 255 F.3d at 828. Koch had acquired the pipeline as part of a $200 million package that also included a storage and terminal company, as well as a natural gas company. Koch, 4 S.T.B. at 657 n.60. Koch argued that the $77.2 million figure used by the Board was not Koch's true acquisition cost, but rather the previous owner's depreciated original cost as of the date Koch bought the pipeline. CF Industries, Inc., 255 F.3d at 828.

29 Id. at 828-829 (citations omitted).

30 The Board's request for additional information did not include providing a justification for any "write-up" of the pipeline investment base, as DNI suggests. DNI Opposition at 2.

Furthermore, the Board's use of acquisition cost in Koch was the primary basis for the rate prescription it imposed in that case that exists today. In deciding whether there has been a material change in circumstances since the Board imposed the prescription, the Board must consider any change in acquisition cost. It would be not only inconsistent with Koch, but also arbitrary and capricious to decide that the principles set forth in Koch should not be applied to Koch's successor in deciding whether to lift the prescription.

B. Even Assuming, Arguendo, that the Board Were to Make a New Revenue Adequacy Determination in this Proceeding, There is No Reason to Depart from Board Precedent.

DNI correctly states that the Board accepts acquisition-based write-ups of railroad rate bases in its annual revenue adequacy determinations, as well as in its merger and maximum rate cases.[31] However, DNI requests that the Board "re-examine its reasons for ruling as it did in the railroad context" before applying its precedent to this proceeding—notwithstanding the fact that it applied the same policy in the Koch case, as discussed above. To advance this suggestion, DNI argues that the Board should depart from its 14-year policy of using acquisition cost valuation—including any write-up or write-down, as appropriate—and apply FERC policy relating to public utilities.[32] DNI's argument is no different from CFI's and adds nothing to the record in this proceeding.

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31 DNI Opposition at 6.

32 Id. at 5-9 (citing Southern Natural Gas Co., 100 FERC ¶ 61,284 (2002) and FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944)). Despite this suggestion, DNI explicitly acknowledges that the Board has ruled that Hope does not apply to Board-regulated entities. DNI Opposition at 6.

As Kaneb noted in its Rebuttal to CFI, the Board is "not bound in any respect by FERC's methodological approach" and the decisions of FERC are not binding upon it.[33] Indeed, Kaneb is not a public utility, and the Board should decline DNI's invitation to apply public utility law to the pipelines it regulates—just as it does not apply such law to the railroads it regulates. In arguing that the Board's "railroad-centric acquisition-cost investment base standards" cannot apply to the Board's jurisdictional pipelines, because the pipeline world is "clearly so very different from the railroad world usually addressed by the Board,"[34] DNI, like CFI, is attempting to rewrite the statutory and regulatory history of AA pipelines.

In deciding that its jurisdiction extends to AA pipelines, the Board's predecessor agency, the ICC, discussed the differences between AA pipelines and oil pipelines, as well as other FERC-regulated transmission providers and concluded that they are entirely separate industries.[35] The ICC also found practical reasons for retaining jurisdiction over AA pipelines, among them, that, "[f]rom a regulatory perspective, transportation rather than energy issues predominate."[36] This belies DNI's suggestions that public utility

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33 Ashley Creek Phosphate Co. v. Chevron Pipe Line Co., et al., 1992 ICC LEXIS 58, at *16-17 (ICC served March 30, 1992). Like CFI, DNI apparently is unwilling to accept that FERC's policy and jurisdiction no longer extend to AA pipelines. See CF Industries, Inc. v. FERC, 925 F.2d 476, 477 (D.C. Cir. 1991) (affirming FERC's decision that it lacks jurisdiction over anhydrous ammonia pipelines, even though CFI "wished FERC, rather than the ICC, [would] assert jurisdiction over . . . transportation of anhydrous ammonia merely because FERC was perceived in some undefined way as the more 'hard-nosed' regulator.").

34 DNI Opposition at 8-9.

35 Gulf Central Pipeline Company – Petition for Declaratory Order, 7 I.C.C. 2d 52, 1990 MCC LEXIS 146, at *12-13 (ICC served Oct. 4, 1990).

36 Id. at *14-15.

policy—promulgated and implemented by another agency—is appropriate for application to AA pipelines.

DNI cites two basic rationales for accepting acquisition-based asset write-ups in the railroad context. DNI erroneously states that neither rationale applies to Board-regulated pipelines in general or to Kaneb in particular.[37] First, DNI's contention that one of the Board's rationales for using acquisition cost valuation in the railroad context is because railroads must keep their books in accordance with GAAP is inapposite. In addition, its statement that the Board's accounting rules do not apply to pipelines is simply incorrect. In the first instance, all business enterprises that provide audited financial statements for financial reporting purposes, including AA pipelines such as Kaneb, must keep their books in accordance with GAAP. DNI's attempt to make the "lower of acquisition cost or fair market value " GAAP rule an anomaly of railroad accounting is ludicrous. Indeed, Financial Accounting Standards Board Statement No. 141 which is referenced by DNI,[38] applies very broadly to all business combinations, including asset acquisitions.[39] Moreover, the Board has applied its "railroad" accounting rules regarding the use of acquisition cost to the other entities that it regulates. As noted above, in using Koch's acquisition costs as its investment base, the Board made clear that

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37 DNI Opposition at 6-8.

38 DNI Opposition at 7 n.12.

39 Financial Accounting Standards Board Statement No. 141, ¶ 9 (June 2001). It is worth noting, however, that a business enterprise would recognize goodwill only in a situation where the price it paid is greater than the fair value of the net assets acquired. See id. at No. 141, ¶ 43; see also id. at No. 141, App. F (defining fair market value as the amount at which an asset could be bought or sold in a current transaction between willing parties; not a forced or liquidation sale). No evidence has been submitted in this proceeding, despite DNI's suggestion to the contrary, that Kaneb paid more than fair market value for the pipeline assets it purchased from Koch.

its approach was fully consistent with GAAP for reporting asset values and related expenses, citing rail accounting principles for this concept.[40] To the extent DNI suggests that keeping books in accordance with GAAP is unique to railroads, or that the Board has not applied rail accounting principles outside of the rail context, DNI is wrong.

Second, ignoring the fact that in many instances, railroad traffic is not competitive and is subject to prescribed rates,[41] DNI contends that competitive factors make railroads unique, and, therefore, this rationale for the Board's use of acquisition cost valuation cannot be applied to pipelines generally, or to Kaneb in particular.[42] Moreover, contrary to DNI's assertions that there are no competitive alternatives to pipelines in general or Kaneb's pipeline in particular, the Government Accountability Office has determined that there are, in fact, other modes of supplying and transporting pipeline commodities.[43] DNI further argues, in effect, that because the majority of Kaneb's customers are captive,[44] the Board should not allow Kaneb to use a change in acquisition cost to support its claim of materially changed circumstances, despite the fact that acquisition cost was used by the Board in prescribing Koch's rates.[45] DNI ignores the fact that acquisition

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40 Koch, 4 S.T.B. at 658-59.

41 See, e.g., Arizona Public Service Co. v. Burlington N. & Santa Fe Ry. Co., 2 S.T.B. 367 (1997); FMC Wyoming Corporation v. Union Pacific Railroad Co., 4 S.T.B. 699 (2000).

42 DNI Opposition at 7-8.

43 See, e.g., GAO Report at 9 (stating that AA is supplied to the Midwest through four sources: local production, pipeline, barge and rail).

44 DNI erroneously states that the Board ruled in Koch that Kaneb did not face effective competition for traffic at most destinations at issue in that case. DNI Opposition at 8 n.15. Kaneb purchased the AA pipeline from Koch several years after the Koch case was decided, and Kaneb was not a party to the Koch case.

45 DNI also argues that pipelines are different from railroads, because they "carry only one homogeneous commodity." DNI Opposition at 8. Such an assertion is illogical.

cost does not even come into play unless the Board first determines that a carrier is market dominant for the traffic or movement to which a rate applies.[46] Therefore, it is incorrect to suggest that acquisition cost should not be used when a carrier has captive customers. Acquisition cost is a component of the revenue adequacy test, which is one constraint under the Board's Constrained Market Pricing ("CMP") and was the constraint selected by CFI in the Koch case. As the court stated in its review of the Koch decision: "The purpose of CMP is 'to ensure that a carrier does not use its market dominance to charge its captive shippers more than they should have to pay for efficient . . . service.'"[47] DNI, and CFI, would have the Board determine that in cases where a carrier's acquisition cost is higher than its historic book value, acquisition cost cannot be considered, even in a proceeding to vacate a prescription that was based on acquisition cost. There is no support for this argument. The Board has made clear that acquisition cost is a more accurate measure of asset value, whether it is higher or lower than historic book value.[48]

In addition, DNI's theory would result in a strange hybrid of FERC and Board rate review methodologies. As Kaneb demonstrated in its Rebuttal to CFI's Reply, the statutes under which public utilities and common carriers are regulated reflect different Congressional concerns and purposes. Although both the Board—under the ICCTA—

Pipelines, as well as railroads, face intermodal and other competitive traffic for the commodities they carry. See Koch, 4 S.T.B. at 655; see also GAO Report at 9.

46 Market dominance is not an issue in this case. For purposes of demonstrating materially changed circumstances, Kaneb does not allege that there has been any change in market dominance. However, Kaneb reserves the right to challenge any claim of market dominance in future complaint proceedings.

47 CF Industries, Inc., 255 F.3d at 826-27.

48 CSX Corporation, et al., 3 S.T.B. 196, 265 (1998). DNI also makes various unsubstantiated allegations that imply that Kaneb's purchase price was inflated. DNI Opposition at 8 and n.16. DNI has introduced no evidence whatsoever to support these allegations.

and FERC—under the Federal Power Act ("FPA") and the Natural Gas Act ("NGA")—are concerned with ensuring reasonable rates, the agencies accomplish that goal differently. Congress intended that regulation of common carriers, including pipelines which transport commodities other than oil and gas, be much more light-handed than for public utilities.[49] Ratemaking and rate reasonableness reviews are also conducted differently under the respective governing statutes. Under the FPA and NGA regulatory schemes, there is no concept of CMP or revenue adequacy; instead, rate regulation is generally cost-based. DNI would have the Board retain its CMP principles, but use the FERC standard of investment base for revenue adequacy determinations only in the case of AA pipelines that pay a higher price for assets than historic book value. Such a self-serving ratemaking methodology would be absurd, as well as contrary to Board precedent and Congressional purpose.

Finally, DNI simply ignores the Board's other rationales for applying acquisition cost valuation, and how they apply to the entities the Board regulates. Primarily, the ICC adopted acquisition cost valuation because it believed that a purchase price negotiated at arm's length is a more accurate reflection of an asset's value than its historic book value.[50] In rejecting the use of book value, the Board has stated that "carriers cannot attract and retain capital unless they are given the opportunity to be compensated for the

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[49] Contrary to DNI's argument, one of the main reasons the ICC rejected application of Hope is because public utilities are more heavily regulated. See Railroad Revenue Adequacy Determination – 1988 Determination, Ex Parte No. 483, 6 I.C.C. 2d 933 (1990), 1900 ICC LEXIS 427, at *19-20.

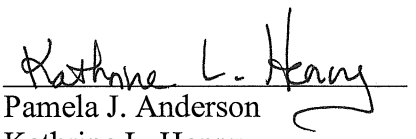
[50] See, e.g., CSX Corporation, 3 S.T.B. at 265 (a purchase price agreed to by commercially sophisticated buyer and seller represents "by far" the best evidence of the current market value of the property) (emphasis added).

real value of the property, not just the book value."[51] This rationale is certainly not railroad-specific; the Board applied this principle in Koch, and the Board's use of acquisition cost valuation for pipelines was upheld by the D.C. Circuit.[52] DNI's attempt to re-write the Koch decision and court-approved Board policy should be rejected.

IV. CONCLUSION

WHEREFORE, in consideration of the above and foregoing, Kaneb respectfully requests that the Board lift the rate prescription it imposed in CF Industries, Inc. v. Koch Pipeline Company, L.P. based on materially changed circumstances, and restore ratemaking initiative to Kaneb.

Respectfully submitted,



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Dated: October 27, 2004

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51 Id.

52 CF Industries, Inc., 255 F.3d 816.

CERTIFICATE OF SERVICE

Pursuant to Rule 1104.12 of the Surface Transportation Board's Rule on Service of Pleadings and Papers, I hereby certify that I have this day served a copy of the foregoing document by hand delivery upon all parties of record in this proceeding.

Dated at Washington, D.C., this 27th day of October 2004.

Kathrine L. Henry